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UNCLAS HARARE 001616

SIPDIS

STATE FOR AF/S
NSC FOR SENIOR AFRICA DIRECTOR JFRAZER
USDOC FOR 2037 DIEMOND
TREASURY FOR OREN WYCHE-SHAW
PASS USTR FLORIZELLE LISER
STATE PASS USAID FOR MARJORIE COPSON

E. O. 12958: N/A

TAGS: [ECON](#) [EINV](#) [PGOV](#) [ELAB](#) [ZI](#)

SUBJECT: Harare's Inflation Woes

1. Summary: High inflation and negative real interest rates continue to wreak havoc on the pensions and savings of many Zimbabweans. The Zimdollar is in freefall, now trading at Z\$5,000:US\$ 1. While select high-end investors have profited from Zimbabwe's collapsing currency and runaway inflation, most people are only beginning to realize how much they have lost. End Summary.

"A penny borrowed is a penny earned"

2. Negative 300 percent real interest rates have fostered a Bizarroworld of finances, flipping conventional wisdom on its head. Debt is good, savings foolhardy. Consider the following:

- A high-interest savings account over the past 12 months would have returned 50 percent, turning Z\$ 1 million into Z\$ 1.5 million. Viewed nominally, not bad. Yet in real U.S. dollars terms, that initial Z\$ 1 million was worth US\$ 1,449 on August 5, 2002 and the final Z\$ 1.5 million worth only US\$ 300 on August 5, 2003. The one-year investment lost a whopping 79 percent.

- This explains what has happened to Zimbabwean pensioners several times over since 1999. The GOZ requires public pension funds to invest most of their assets in Treasury bonds, lending to Government at negative rates. Pensioners tell stories of monthly checks that once paid rent and now not even buy a six-pack of coke.

- Inflation continues to outpace salaries. In real terms, workers earn less than one-quarter what they did in 1995. A factory owner told us the same worker he paid US\$ 80/month in 1995 now earns the equivalent of US\$ 10.

- Workingmen must also fight tax bracket creep. 20 percent personal income taxes begin to kick at the Z\$15,000 (US\$ 3) monthly salary threshold. A factory worker who earns Z\$ 48,000 (US\$ 10)/month lands in the "high-income" 35 percent bracket.

Comment

3. Although still partly deluded by large nominal increases in salaries, Zimbabweans are beginning to appreciate that buying power is slipping through their fingers. In a sense, we are witnessing a large redistribution of wealth - from net creditors to net debtors, from savings accounts to government spending. This has annihilated Zimbabwe's enviable savings rate (from 9 percent of GDP in 1999 to -3 percent today). At the same time, we see the emergence of entrepreneurial Zimbabweans, especially in several indigenous banks, who understand how to profit from high inflation, that the rules of the game are changing fast.

Whitehead